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SUBJECT: BRAZIL'S PORT LEGISLATION AND SANTOS CASE STUDY

SENSITIVE BUT UNCLASSIFIED

11. (SBU) Summary: Port bottlenecks have historically been a major cost of doing business in Brazil. The GOB is hoping the new Brazilian ports decree, made effective on October 29 allowing private ports concessions and simplifying the regulatory framework regulating the construction and modernization of Brazilian ports, will help improve infrastructure deficiencies. The private sector's support for the new rules has been mixed. The Minister of Ports expects USD 9.5 billion in new investments over the next five years. Current port infrastructure challenges include the lack of physical capacity, long wait times at port, and long delays to obtain environmental licenses for port dredging and expansion. The port of Santos, South America's largest, is an example where all three of these issues have created significant backlogs. The Santos Port Authority (CODESP) has two large projects in the pipeline, Embraport and the Barnabe-Bagres project, which they hope will help meet this demand and streamline the process. While increasing Brazil's trade flows greatly depends on the country's ability to improve its port infrastructure and reduce the additional costs of doing business in Brazil, the global financial crisis could limit financing for these projects, as well as diminish demand in the short term. End Summary.

New Legislation

12. (U) President Lula signed a decree on October 29 creating new regulations for Brazilian port development and modernization. The decree broadens the ability of firms to operate separate elements of port facilities, allows for private port concessions via a competitive bidding process, requires operators to publicize and charge reasonable tariffs, and unifies the regulatory framework. The new decree likewise ends a regulatory conflict that undermined private sector investments into the sector. The previous legislation defined two modalities for private sector ports: public use ports via concessions for providing services to third parties and private use terminals to manage a company's own cargo. To reduce idle capacity, private terminal operators developed a "mixed-use" concept. However, companies were required to prove their own cargo was sufficient to justify the private investment, which dissuaded large companies from investing. The new decree requires private investors only to prove that they move their own or

third party cargo.

¶3. (U) The GOB stated that the new model would not deter the private sector and likened it to reform of the electricity sector. However, some potential investors are concerned over interpretations of the new port decree that indicate the possibility of eminent domain taking away an owner's property if the owner proposes to build a port on his land and loses the bidding process. Eike Batista suspended plans for a USD two billion private port project in Peruibe, in the state of Sao Paulo, for just this threat of expropriation. If this rule does indeed apply, it could both stifle new port development and/or lead to increased corruption with officials seeking to make certain that the concession comes out the "right way". The Special Minister of Ports Pedro Brito underscored that previously submitted private sector proposals worth USD 9.5 billion over the next five years meet the new requirements, but it remains to be seen whether other private investors will endorse the new legislation.

Ports Inefficiencies

¶4. (SBU) The growth in Brazilian exports, especially manufactured goods, has greatly increased the importance of container port terminals in Brazil. Between 2002 and 2007, the South American Eastern seaboard container volume doubled, while ports only grew on average by 14 percent. As ships become larger, Brazil needs longer berths and deeper channels to accommodate the increase in volume. Jose Antonio Cristovao Balau, Director of Alianca Navegacao e Logistica outlined the bottlenecks of several Brazilian ports at a recent Latin Finance conference. The container volume at the Port

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of Santos, for example, increased 135 percent, from 714,000 containers in 2001 to 1.68 million in 2007. The city of Santos would like to offer the port authorities more space but has none to offer, a problem that Balau noted existed for all Brazilian ports with the exception of Suape and Pecem (both in Northeastern Brazil).

¶5. (SBU) Similarly, Balau highlighted that wait time is a critical metric to be improved. He explained that at Santos 31 percent of ships wait up to three hours, 15 percent from three to six hours, 19 percent from six to 12 hours, and 20 percent from 12 to 24 hours. Alianca expected container capacity in Brazil to be 8.6 million containers in 2012, which would require an additional capacity of 5.4 million square meters within four years. Without improved port efficiency, these wait time and concurrent costs will simply rise, undermining Brazil's ability to compete in the world market.

¶6. (SBU) Finally, as with many infrastructure projects in Brazil, environmental permits were often cited for delays. Balau said the three projects Alianca is developing all waited a minimum of six years to secure environmental permits. Its Embraport project (Santos, should be operational in 2010) was approved in 1999, but did not get an environmental license until 2006. The Portonave project (Itajai) was approved in 1997, received its environmental permit in 2005, and began operating in 2007. Itapoa should be operational next year, more than 10 years after its approval in 1997 and environmental permit in 2003. Note: New Minister of the Environment, Celso Minc, has made public his desire for quicker environmental permitting in Brazil and there has been some movement in that direction. End Note.

A Case Study: Port of Santos

¶7. (U) The port of Santos is located in a protected region in the Bay of Santos, approximately 40 miles from Sao Paulo. The busiest port in the Southern Hemisphere, Santos has the largest container terminal in Latin America. More than 35 percent of Brazil's maritime cargo and half of all container movement passed through Santos in 2007. The focal point of regional transport networks, including highways, railways, oil pipelines, and inland waterways, Santos is the main port for trade flows from Sao Paulo State, Minas Gerais, Mato Grosso, Mato Grosso do Sul, Goias, Parana, and the

Federal District of Brasilia. These states accounted for more than half of Brazil's GDP and foreign trade worth USD 71 billion in 2007. Santos liberalized some port operations in 1995 and has developed private terminals. A private firm manages all of Santos' passenger and goods movements. The number of permanent employees fell from 16,000 in 1993 to 1,400 in 2007 and productivity per employee increased from 4,000 tons to 57,250 tons per year in that same timeframe.

¶8. (SBU) Despite these efforts, the infrastructure at Santos does not meet current demand. The Santos Port Authority (CODESP) recently launched efforts to improve infrastructure, build new berths, extend the quays, and increase storage and warehouse capacity. CODESP estimates that Santos should move 110 million tons per year when the construction of the Guarujá Bulk Terminal (TGG) is completed. Despite these efforts, CODESP estimates that Santos would need additional capacity by 2014. CODESP Marketing and Business Development Executive, Fabio Oliari told Econoff that they are evaluating the medium and long term actions required to absorb the additional demand. Over the short-term, CODESP is also reviewing ways to improve access to the port, as well as speed up the movement of goods.

New Terminals to Increase Capacity

¶9. (U) Alianca Navegacao e Logistica is building Embraport, a new terminal at Santos, at an estimated cost of USD 700 million which should be operational by 2010. Embraport would be Brazil's largest private port terminal. Embraport's pier for bulk liquid cargo would facilitate Brazil's ethanol exports. The state of Sao Paulo

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produces nearly 65 percent of national ethanol exports. The terminal would increase container traffic, reduce wait times and handling and storage fees, and increase specialization among the existing terminals.

¶10. (SBU) CODESP also plans to develop another terminal as a public-private partnership (PPP) in tandem with the federal government at an estimated cost of USD five billion. Feasibility studies for the Barnabe-Bagres project are underway to then obtain the environmental license. The project would increase capacity by more than 120 million tons, add 45 new berths, new storage facilities, and the latest generation equipment. Fabio Oliari told Econoff that Barnabe-Bagres expansion project would double current cargo movement capacity at the port, and generate nearly 20,000 new jobs as well as some 15,000 jobs during the construction phase.

Comment

¶11. Brazil's economic and social development is dependent on the country's ability to move goods and services. Much of the so-called "Custo-Brazil-cost of doing business in Brazil" results from poor infrastructure and high transportation costs. While the new legislation is a step in the right direction to correct the regulatory inconsistencies, the GOB may not have resolved all the investment concerns to get private sector buy-in. The comparison to electricity reform will not go unnoticed because private investors have been dissatisfied with the GOB's reforms made in 2003 to that sector. Likewise, the global credit crunch could delay financing for infrastructure projects. Three port projects under construction for a total of USD 1.7 billion remain unfinanced. The global economic downturn would likely reduce port traffic, but capacity shortfalls are expected regardless. End Comment.

¶12. This cable was coordinated/cleared by Embassy Brasilia.

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